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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services	)	CC Docket No. 96-112

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COMMENTS OF AT&T CORP.

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TABLE OF CONTENTS

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COMMENTS OF AT&T CORP.

Pursuant to the Commission's Notice of Proposed Rulemaking ("Notice") in this proceeding, AT&T Corp. ("AT&T") submits these comments on the Commission's proposal to amend its cost allocation rules regarding an incumbent local exchange carrier's ("LEC's") use of the same network facilities to offer both regulated and nonregulated services (such as video programming). AT&T supports the Commission's tentative conclusion to amend the cost allocation rules so that an appropriate portion of the LECs' costs are allocated to nonregulated activities.

I. Introduction and Summary

The 1996 Act[1] has ushered in an era of far-reaching changes in the telephone industry, including especially the implementation of a new national policy of

[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56 (1996) (hereinafter the "1996 Act").

competition in local markets. For this new policy to be realized, it is imperative that prices for telephone services reflect their true economic costs. Pricing these services at their true economic costs not only permits fair competition, but also promotes efficient investment and entry decisions.

As long as incumbent LECs maintain a virtual monopoly on the access services on which interexchange carriers are dependent, it is particularly critical that the prices for these monopoly services not be loaded with uneconomic costs. That is why the Act requires access charge reform, and mandates that incumbent LECs "not use services that are not competitive to subsidize services that are subject to competition."[2] These statutory mandates underscore the importance of structuring Part 64 of the Commission's Rules to take into account a reasonable allocation of joint and common costs between activities regulated under Title II and nonregulated activities.[3]

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[2] Section 254(k) of the 1996 Act.

[3] The Commission also has ample statutory authority, under Section 201 of the Communications Act, to mandate the allocation of costs between LECs' regulated and nonregulated activities, in order to ensure just and reasonable local exchange and exchange access pricing. See Separation of Costs of Regulated Telephone Service from Cost of Nonregulated Activities, Report and Order, 2 FCC Rcd 1298, 1309 (1987), modified on recon., 2 FCC Rcd 6283 (1987), modified on further recon., 3 FCC Rcd

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As the Commission correctly notes (Notice, para. 23), the cost allocation rules should be designed to allocate a significant portion of common costs to nonregulated services, to prevent the uneconomic loading of costs on regulated, monopoly services. Such allocation is critically important at this time for two reasons. First, the costs associated with nonregulated services, particularly video programming, will be significant.[4] Moreover, to the extent that economies are realized in the provision of telephone services when the plant used to provide those services is shared with competitive activities, a portion of the resulting cost reductions should be passed on to the customers of the LECs' regulated services.[5]

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6701 (1988), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

4 MCI estimated that as of October 1995, the Regional Bell Operating Companies had planned to spend more than $3.3 billion constructing video dialtone systems. Moreover, MCI stated that this expenditure represents only a fraction of what LECs plan to build. Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Comments of MCI, p. 6 and Attachment A, filed October 25, 1995.

5 The cost allocation rules proposed here are consistent with both the above statutory mandates and the Total Service Long Run Incremental Cost ("TSLRIC") approach to pricing of interconnection and unbundled network elements that AT&T and others have proposed in the Commission's

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II. The Shared Cost Portion of Loop Or Switching Plant Should Be Allocated On the Basis Of A Fixed Factor.

Because loop plant is non-traffic sensitive, AT&T supports the Commission's tentative conclusion (Notice, para. 40) that a fixed factor for allocating the shared costs of loop plant between regulated and nonregulated activities be prescribed. To that end, AT&T proposes a fixed factor based on TSLRIC studies,[6] that will establish an appropriate and fair cost relationship between the regulated and nonregulated activities associated with dual-purpose loop plant.[7] Specifically, AT&T recommends the adoption of the following methodology:

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on-going proceeding to implement Sections 251 and 252 of the 1996 Act. See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Comments of AT&T Corp., filed May 16, 1996, pp. 62-66 ("AT&T Local Competition Comments").

[6] The TSLRIC of an unbundled network element is the sum of all of the additional costs that an efficient supplier would incur to supply all of the output of that element that is demanded by all uses and users of that element, assuming that the supplier continued to provide its other network elements, services and functionalities. In other words, TSLRIC includes forward-looking costs -- i.e., true economic costs.

[7] This process is intended only to be used to allocate the costs of dual-purpose loop plant capable of providing both video and telephone services, and not to loop plant used solely to provide either telephony or video.

1. separate TSLRIC studies[8] are performed for a video-capable loop plant, given that this plant already provides telephony, and for a telephony-capable loop plant, given that this plant already provides video;
2. an allocation factor is then calculated by dividing the TSLRIC study result for a telephony-capable loop plant by the sum of the two TSLRIC studies identified in 1 above;
3. the resulting factor (from 2 above) is applied to the shared portion of the LECs' costs of dual-purpose loop plant. This shared portion is equal to the efficient, forward looking costs of the dual-purpose loop plant minus the sum of the individual TSLRIC studies identified in 1 above; and
4. the total cost of dual-purpose loop plant to be assigned to telephony then equals the TSLRIC of telephony-capable loop plant identified in 1 above, plus the telephony portion of shared costs identified in 3 above.[9] The total cost identified

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8 TSLRIC studies should be performed pursuant to an approved TSLRIC model, such as the Hatfield Model proposed by AT&T in its Local Competition Comments, p. 51 and Appendix E.

9 For example, if a LEC's TSLRIC study results for a video loop plant is $3 billion and for a telephony loop plant is $2 billion, then the allocation factor for telephony would be $2 billion/$5 billion, or 40%. If the efficient, forward looking costs of the dual-purpose loop

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here must not exceed the stand-alone cost of a telephony-only loop plant.

The benefits of this approach are numerous. First, a fixed factor is simple to understand and apply. Moreover, each incumbent LEC will apply the fixed factor in the same manner, bringing the certainty and fairness that promote the ability of providers of both telephone and video services to compete effectively.[10] Finally, TSLRIC is administratively manageable, as TSLRIC and related economic-cost-based methodologies are routinely employed in regulatory proceedings and arbitrations. TSLRIC has been adopted or proposed in the telecommunications context by nearly half of the states[11] and by the Commission.[12]

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plant is $6 billion, then the shared cost to be allocated is $1 billion ($6 billion minus $3 billion minus $2 billion). The total cost of the dual-purpose loop plant that would be assigned to telephony would then be its $2 billion TSLRIC plus 40% of the $1 billion of shared costs, which equals $2.4 billion.

10 Notice, para. 25.

11 Arizona, California, Colorado, Connecticut, Hawaii, Illinois, Iowa, Louisiana, Michigan, Minnesota, Nevada, Ohio, Oregon, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming are among the states that have embraced TSLRIC in some context.

12 See Notice of Proposed Rulemaking, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, 1996 FCC Lexis 77, paras. 47-48 (January 11, 1996).

AT&T recommends that its proposed allocation process be implemented three months from the effective date of the Commission's Order in this proceeding, which will afford incumbent LECs more than sufficient time to perform the TSLRIC studies. In the interim, AT&T recommends that the Commission establish a fixed factor that assigns 50 percent of the shared costs of dual-purpose loop plant to regulated activities and 50 percent to nonregulated activities. The use of such an interim factor will ensure that nonregulated activities are allocated a reasonable portion of shared costs, until the more specific TSLRIC-based allocation can be implemented.[13]

The Commission also seeks comment (Notice, paras. 35-36) on whether it would be reasonable to allocate shared local loop costs by establishing a ceiling based on the costs of the current loop plant, capping the level of costs an incumbent LEC may assign to regulated activities. In essence, the Commission proposes to cap the LECs' local loop costs at the current level, presumably without changing the current Part 64 allocation, and only allow annual changes by

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[13] Because the allocation method proposed above is an economically rational approach, easy to administer, and fair, AT&T does not endorse any of other the allocation methods proposed by the Commission (see Notice, paras. 28-34: direct assignment, allocations based on usage measurements, and allocation based on the ratio of directly assigned costs).

adding the inflation factor and subtracting the LEC's productivity factor.[14]

The effect of this proposal would be to keep the costs allocated to regulated activities artificially high, because by simply capping the local loop costs, instead of reallocating costs for shared plant under Part 64, the Commission would forego mandatory loop cost reductions assigned to regulated services when the economies of shared use of loop plant would otherwise warrant such reductions.[15]

The Commission also seeks comment (Notice, paras. 43-44) on whether incumbent LECs should continue to be required to allocate switching costs between regulated and nonregulated activities based on relative usage. While this approach is adequate when, as is the case today, most traffic switched at the incumbent LECs' central offices involves regulated service, it is not appropriate when a significant portion of switched traffic involves

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[14] Notice, para. 36.

[15] By way of example, if the cost of the local loop plant is \$4 billion today, all \$4 billion are assigned to the LEC's regulated account. Under the Commission's proposal, this \$4 billion will serve as the ceiling for regulated activities, and it can only be adjusted by the "modified price cap" formula. If in the following year the LEC also provides video services, \$4 billion will still be allocated to the LEC's regulated account, even if the loop plant is used to provide both telephony and video services.

nonregulated, video services traffic. AT&T recommends instead that the shared costs of dual-purpose switching plant should be allocated using the same methodology as proposed for allocating the shared costs of dual-purpose loop plant.[16]

III. Expenses Should Be Allocated Consistent With The Plant Or Switching Equipment With Which The Expenses Are Associated.

The Commission seeks comment (Notice, paras. 47-50) on the appropriate methods to allocate expenses. AT&T supports the Commission's tentative conclusion (Notice, para. 47) that the allocation of network-related expenses be based on the network plant allocation. Under Part 32 of the Commission's Rules, which establishes the relationship between expenses and the primary cost accounts (loop plant and switching plant), the allocation of the expenses follows the primary cost account. There is no reason to depart from this logical, workable, existing allocation method.

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[16] Prior to implementation of the TSLRIC-based allocation process, the interim 50/50 allocation proposed by AT&T should also be employed.

IV. Treatment of Cost Reallocations Under Price Cap Regulation.

The Commission also seeks comment (Notice, paras. 58-64) on whether, under the price cap rules, reallocations of regulated costs to nonregulated accounts should trigger decreases in related price cap indices. The answer is clear. The price cap rules already define exogenous cost changes as "those [changes] caused by . . . [t]he reallocation of investment from regulated to nonregulated activities pursuant to" the Commission's Part 64 cost allocation rules.[17] AT&T agrees with the Commission (Notice, para. 60) that this rule establishes a presumption that cost reallocations due to changes in the Part 64 cost allocation process are exogenous, and thus require decreases in related price cap indices.

In addition to the rule's clear and unambiguous language, the Commission has mandated precisely this type of exogenous cost adjustment for all reallocations of costs from regulated to nonregulated activities.[18] It would thus

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[17] 47 C.F.R. § 61.45(d)(1)(v). See also 47 C.F.R. § 61.44(c)(4).

[18] When the Commission previously addressed this specific issue, it found that the reallocation of costs from regulated to nonregulated should be characterized as exogenous. The Commission also found that because of differences between rate of return regulation and price caps, "[t]o register the effect of [such] reallocation in a price cap context, and thus give the effect to the Joint Cost rules, we must require an exogenous cost

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be unreasonable <u>not</u> to interpret the price cap rules as requiring cost reallocations due to changes in Part 64 cost allocations as exogenous.

The Commission also seeks comment (Notice, para. 62) on the need for Part 64 processes in the regulation of price cap carriers that are not subject to sharing obligations. AT&T recommends that price cap LECs, whether or not subject to sharing, remain subject to Part 64 processes. As to those LECs that are not currently under a sharing obligation, such LECs' current decision to choose a price cap model that does not permit sharing does not prevent any of those LECs from later electing a different model (i.e., lower productivity factor) which will subject them to the sharing obligation. The Part 64 process is necessary in regulating price cap LECs subject to sharing, because the calculation of a LEC's sharing obligation is dependent, in part, upon the proper allocation investments and expenses.

In all events, <u>all</u> price cap LECs should remain subject to the Part 64 process. If the Part 64 process were

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adjustment to made whenever regulated investment is reallocated to nonregulated activities." Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6807-08 (1990), modified on recon., 6 FCC Rcd 2637 (1991).

to be eliminated for incumbent price cap LECs, it would be difficult to identify and monitor the reasonableness of the LECs' regulated telephone rates to ensure that those rates are not loaded with costs associated with their competitive services. The Commission should thus continue to require all incumbent price cap LECs, including those without a sharing obligation, to comply with Part 64.

CONCLUSION

WHEREFORE, for the reasons stated above, AT&T recommends that the Commission amend its Part 64 cost allocation rules as described in these comments. Further, the reallocation of regulated to nonregulated should be reflected in the LECs' price cap indices as an exogenous cost reduction.

Respectfully submitted,

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